



Health Plans Being Squeezed

Health Plans Expand & Access Equity

National Trends Playing Out in Mid-Atlantic Region

CareFirst Must Gain Substantial Scale & Access Capital

Timing Appears Favorable for CareFirst to Act

CareFirst's Constituents Likely to Benefit

OCC 002094

Plans that have pursued economies of scale realized a cost advantage when implementing fixes for Y2K.

BCBS Plans spent \$1.84 to \$7.41 more per member than other health plans on Y2K

Potential Savings from Economies of Scale* – Y2K Example

Health Plan	Y2K Remediation Expense	1999 Members	Y2K Expense/Member
CIGNA	\$100 - \$125 MM	13.3 MM	\$7.51 - \$9.40
Aetna	\$179 MM	21.0 MM	\$8.52
PacifiCare	\$14 MM	3.7 MM	\$3.83
Humana	\$24 MM	5.4 MM	\$4.45
United	\$79 MM	13.8 MM	\$5.72
BCBSA	\$842 MM	74.9 MM	\$11.24

*Economies of scale may be realized if a company increases its size and proactively integrates its processes/operations

Source: Health Plan SEC Filings, BCBSA; Strategic Consulting Services (division of BCBSA)

Blues plans may have been able to save between \$138MM to \$555MM on Y2K expenditures if they had been able to better exploit economies of scale.

Operating at the per member Y2K expense of its peers, CareFirst could have realized savings of \$138 - \$555 million

Potential Savings from Economies of Scale* – Y2K Example (con't)

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Low Estimate

$\$11.24 - \$9.40 =$
\$1.84
(CIGNA)

High Estimate

$\$11.24 - \$3.83 =$
\$7.41
(PacifiCare)

X

74.9 MM
(BCBSA Membership)

=

**Estimated Y2K
Expenditure**

\$842 MM

(Actual BCBSA Y2K Expenditure)

\$138 MM

Potential Y2K Savings

\$555 MM

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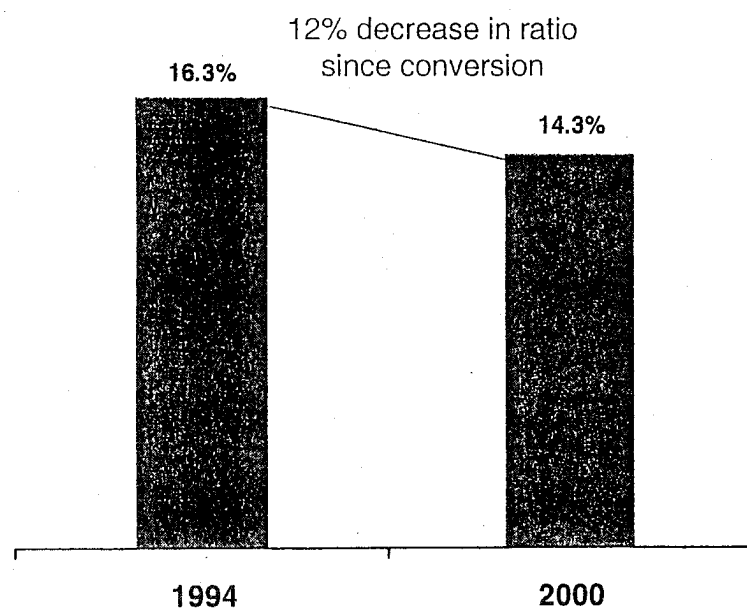
Source: Health Plan SEC Filings, BCBSA; Strategic Consulting Services (division of BCBSA)

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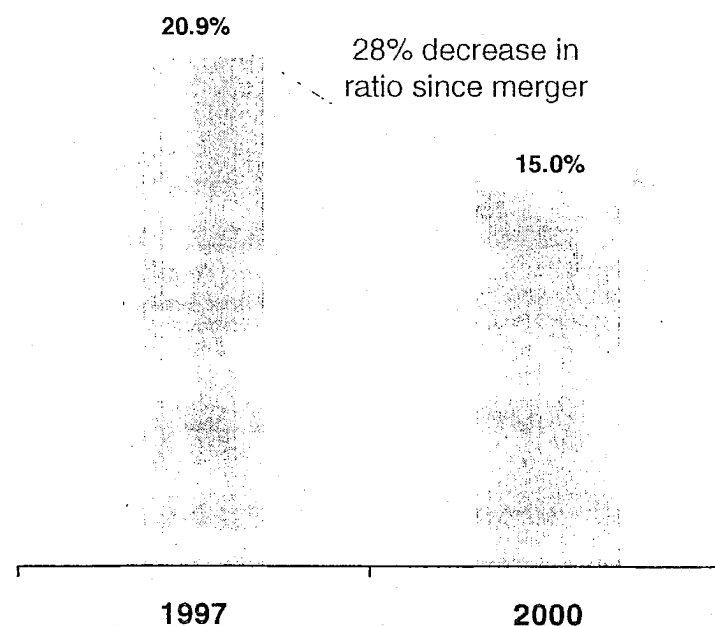
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Both Blue Cross of California and BCBS of Connecticut experienced declines in their respective administrative expense ratios after converting/merging.

Admin Expense Ratio – Blue Cross of California (% of Total Revenue)

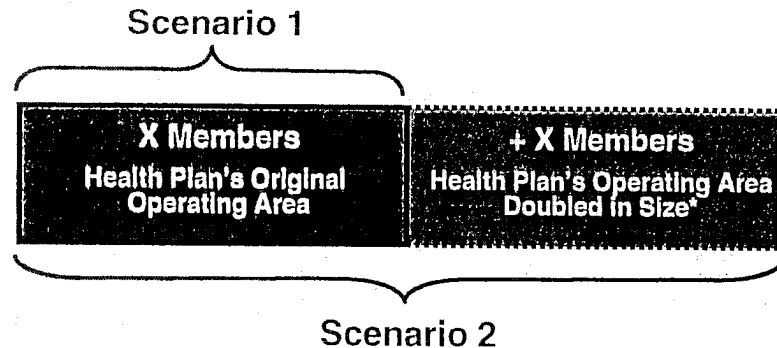


Admin Expense Ratio – BCBS of Connecticut (% of Total Revenue)



Source: InterStudy, The National HMO Financial Database, 1994-2000; data pulled from state Department of Insurance filings

Increased scale can also help stabilize a health plan's earnings, as they have larger bases of business to withstand downturns in individual segments of their businesses.



ILLUSTRATIVE

Scenario 1

A health plan earns a 3.0% profit margin on \$300M in revenue. The plan makes \$9M in net income.

A health plan's margin decreases by 50% to a 1.5% profit margin on \$300M in Revenue. The plan makes 50% less in net income.

Scenario 2

A health plan's margin decreases by 50% to a 1.5% profit margin. However, if the plan is able to double its member base, it will earn \$9M in net income.

**Market share remains constant*

Revenue	\$300M
Operating Margin	x 3.0%
Net Income	\$9.0M

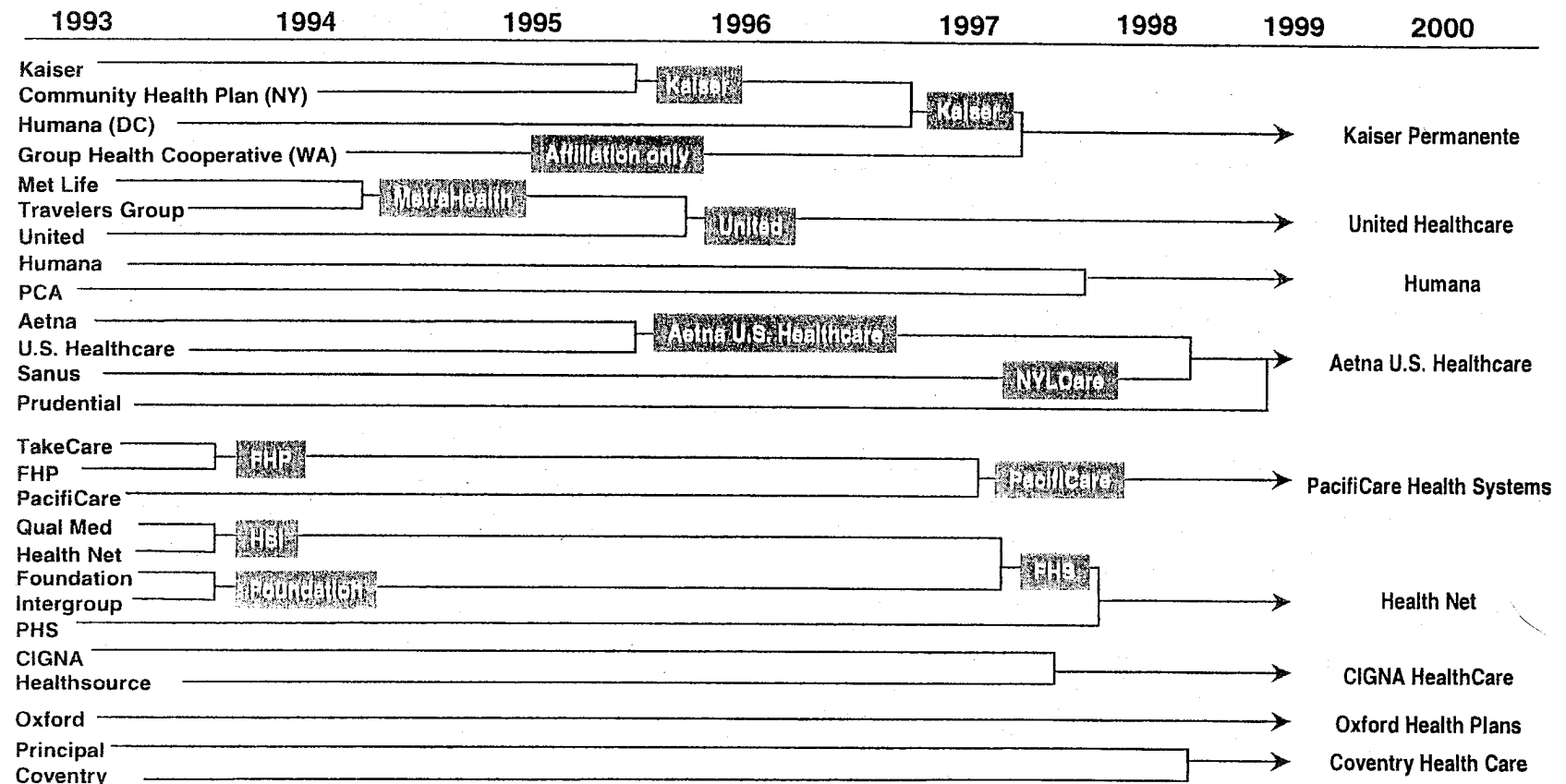
Revenue	\$300M
Operating Margin	x 1.5%
Net Income	\$4.5M

Revenue (Original \$30M + New Revenue \$30M)	\$600M
Operating Margin	x 1.5%
Net Income	\$9.0M

Margins decrease
Income unchanged

There have been a large number of health plan combinations over the past 10 years.

Non-Blue Health Plan Consolidation



OCC 002099

Recent combinations involve large plans acquiring smaller, community-based plans.

Examples of Recent Health Plan Activity

(Non-Blues Health Plans)

Year	Health Plan Activity
1999	<ul style="list-style-type: none"> Health Risk Management, Inc. completed its purchase of Oxford Health Plans of Pennsylvania, Inc and renamed the plan HRM Health Plans, Inc. Health Net, Inc. (formerly Foundation Health Systems) sold its plans in Texas, Oklahoma and Louisiana to AmCareCo, Inc., the parent company of AmCare Health Plans Aetna U.S. Healthcare began offering an HMO and point-of-service plan in the Raleigh-Durham area North Carolina Kaiser Permanente Northeast Division closed effective December 31, 1999 after operations in Connecticut, Massachusetts, New York, North Carolina and Vermont were all sold HealthCare America Plans, Inc. (KS) was acquired by Coventry Health Care of Kansas, Inc. - Wichita
2000	<ul style="list-style-type: none"> Harris Methodist Health Plan (TX) was acquired by PacifiCare Health Systems United Healthcare exited the Pacific Northwest and transitioned its members to Premera Blue Cross in Washington and LifeWise in Oregon Coventry Health Care, Inc. completed it's acquisition of Maxicare Louisiana, Inc. Coventry Health Care, Inc. completed it's acquisition of WellPath Community Health Plans, the managed care subsidiary of Duke University Health System
2001	<ul style="list-style-type: none"> Group Health Plan (MO), a subsidiary of Coventry Health Care, Inc., acquired the commercial membership of Health Partners of the Midwest Coventry Health Care of Kansas, Inc. signed a definitive agreement to acquire Kaiser Foundation Health Plan of Kansas City

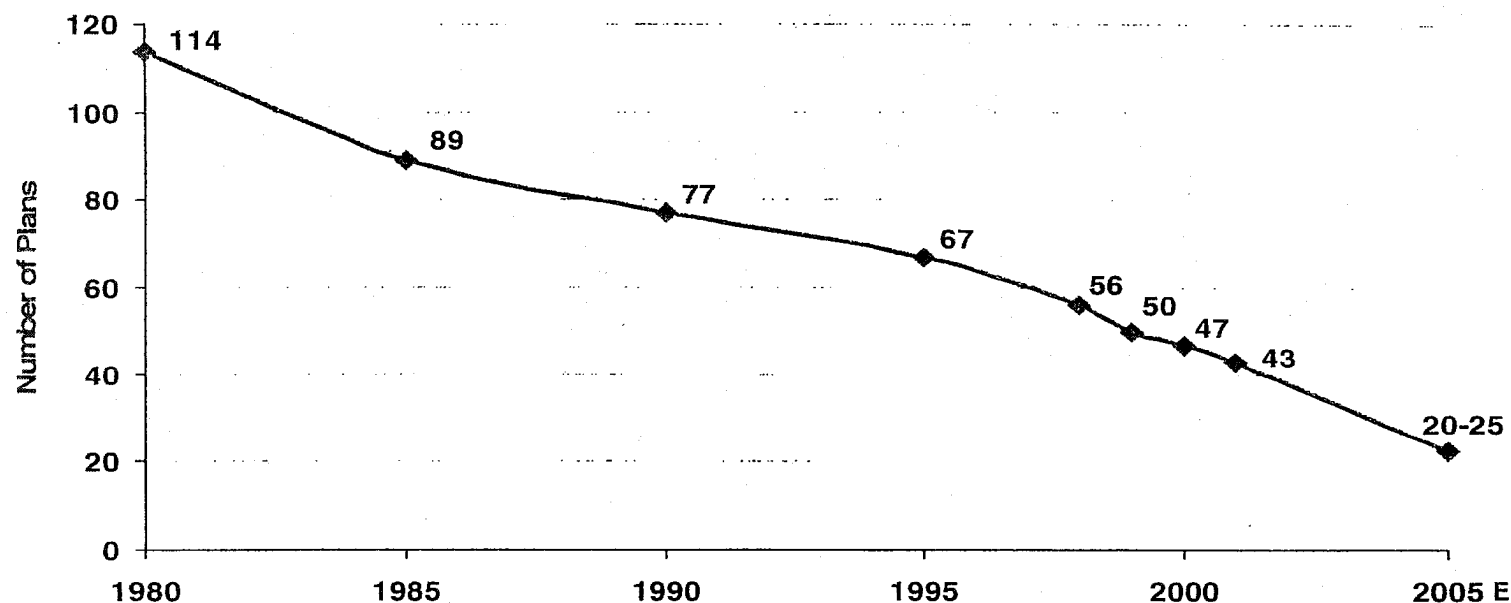
Source: The InterStudy Competitive Edge: HMO Industry Report 10.1 & 11.1, *References: Changes in the HMO Industry*, April 2000 & April 2001

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There has been an unprecedented reduction in the number of BCBS plans from 114 to 43 over the past 20 years, with industry analysts seeing this trend continuing.

Blue Cross Blue Shield Consolidation

(Number of Plans by Year)

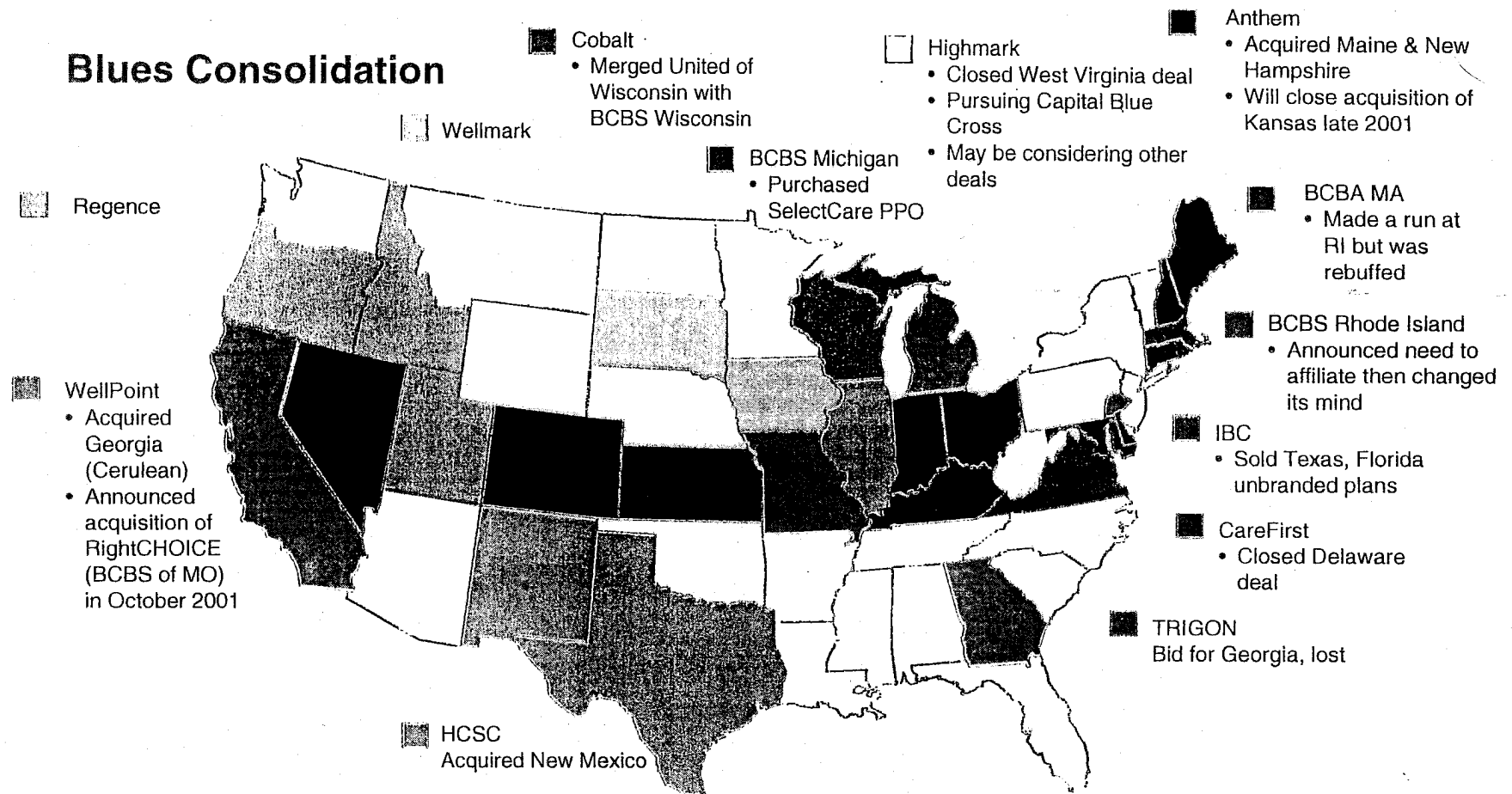


Source: Conning & Company, *The Blue Cross and Blue Shield Plans: Past, Present and Future*, 2000; BCBSA Data for Years: 1980, 1985, 1990 and 2001

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Consolidations of BCBS plans have taken place across the nation.

Blues Consolidation



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Increased financial strength and the flexibility to adjust to a changing market are reasons cited by health care executives that have engaged in conversion/merger activity.

Rationale for Recent Conversions/Mergers

Hospitals

Executive Leadership Viewpoint

**Sharon Hospital,*
CT**

- The hospital was lacking in management systems and experiencing: a declining census and utilization, a lack of adequate capital, the need for physical upgrade of the facilities, the need to update billing and collection technologies, the changing demographics, a fairly competitive environment, and other problems common among rural hospitals (*Dean Cain, Hospital Board Member and Health Care Investment Banker, commenting on the hospital's proposed conversion and sale to Essent Healthcare*)

**Daniel Freeman
Hospitals,* CA**

- Daniel Freeman Hospitals are in a severe financial crisis. Declining reimbursement rates from health plans and the government have led to continued losses over the past several years. Tenet brings the financial strength and hospital management expertise necessary to turn these facilities around and ensure that they continue to offer health services to the community." (*Cathy Ficks, Interim CEO, commenting on the hospitals' proposed conversion and sale to Tenet*)

Health Plans

Executive Leadership Viewpoint

**WellPoint/
RightCHOICE,*
CA/MO**

- We expect to share and implement best practices. For example, we have high regard for RightCHOICE's highly successful programs that have built strong relationships with physicians. (*Leonard Shaffer, WellPoint's Chairman and CEO, commenting on the pending merger of WellPoint with RightCHOICE*)
- Together, we'll have a stronger financial base and access to advanced technology that will provide broader health plan choices and improve communications with our members and physicians." (*John O'Rourke, RightCHOICE's Chairman and CEO, commenting on the pending merger of WellPoint with RightCHOICE*)

**Cobalt Corporation,*
WI**

- This combination will help give us a competitive edge in the ever-changing health care market and create a stronger presence that will benefit both customers and investors. We have long been known as a company that looks to the future, and this combination ensures that our future will be a prosperous one. Our diverse product portfolio demonstrates our commitment to technology, quality partnerships, choice and flexibility." (*Thomas R. Hefty, President, Chairman and Chief Executive Officer, Cobalt Corporation, commenting on the conversion from BCBS United WI & United WI Services to Cobalt Corporation*)

Source: Press releases from websites of the CT Attorney General's Office, Tenet Health, WellPoint Health Networks, Cobalt Corporation

* Conversion/merger still pending

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